GETTING IT RIGHT IN T&T - FISCAL RESPONSIBILITY

Q&A WITH MARLA DUKHARAN

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The persistently weak economy in Trinidad and Tobago is a product of fiscal and broader macroeconomic mismanagement under successive governments. Policy choices have created:

- an economy increasingly dependent on the energy sector;
- an overvalued currency that subsidizes imports, and penalizes exports, by eroding competitiveness for local products;
- unsustainable Government debt, evidenced by recurring primary deficits, meaning we are borrowing just to pay the interest on our existing debt.

What are fiscal rules?

According to the IMF, a fiscal rule is a legislated numerical limit on budgetary aggregates of expenditure, revenues, or deficits and debt. The four main types of fiscal rules are:

DEBT RULES
A numerical limit on the level of public debt as a percentage of GDP

BUDGET BALANCE RULES
Target for the overall budget surplus or deficit

EXPENDITURE RULES
Limits on total, primary and / or current expenditure, and / or on the variables that have repeatedly contributed to debt

REVENUE RULES
Aimed at boosting revenues or decreasing tax burdens by setting revenue ceilings or floors

The most frequently used rules are the Budget Balance Rules and Debt Rules, and drawbacks with individual rules have led most countries to adopt a combination of rules.

The ultimate objective of fiscal rules is to promote sustainable growth, while at the same time controlling deficits and limiting debt accumulation. Fiscal rules will allow policy to better respond to shocks, and facilitate short-term macroeconomic stabilization.

Governments also implement fiscal rules to foster policy coordination between different levels of government, contribute to the reduction of uncertainty about future fiscal policy, control the size of government, and promote cyclical stability.

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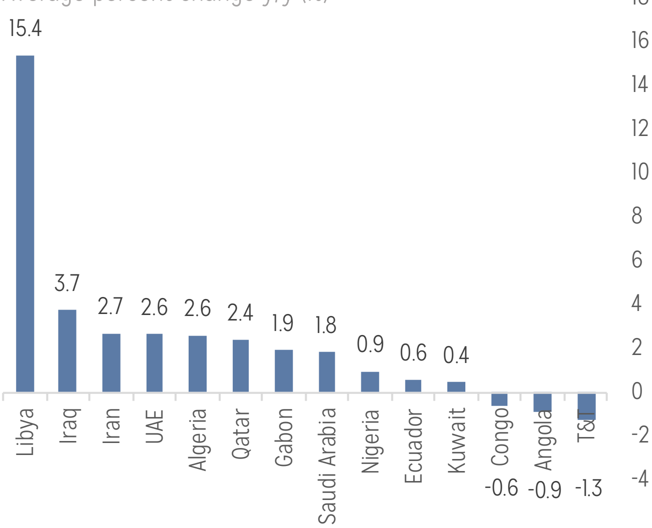
FACT CHECK: Oil prices are not the problem

Blaming economic woes on oil price movements is politically more palatable than addressing the underlying causes of the economic malaise. In May 2019, the Minister of Finance called out the familiar scapegoat, stating: "The present Government has weathered the oil price shock that began in 2014 and which has continued up to the present day."

The data show that T&T in fact has had the worst growth among oil producers (excluding Venezuela) since 2015.

Average GDP Growth Oil Producers: 2015-2018

Average percent change y/y (%)

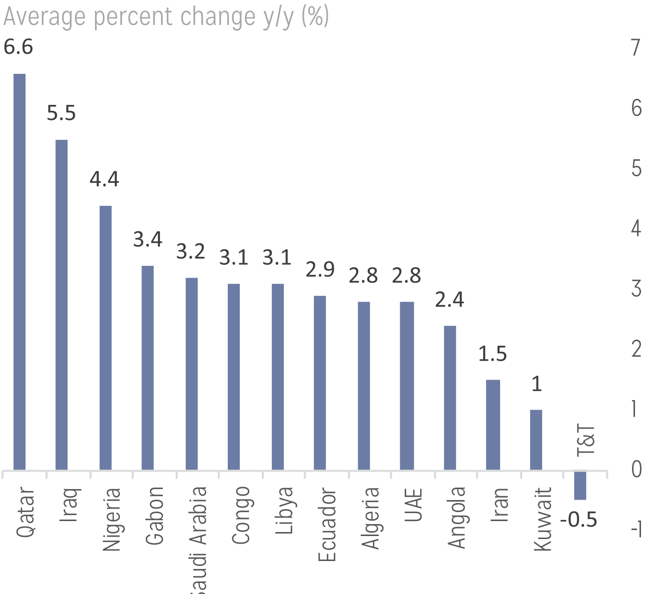


Source: IMF, Central Bank of Trinidad and Tobago, Ministry of Finance, Marla Dukharan

However, looking at growth over the last decade, the data also tells us that T&T has had the worst performance among oil producers including the years of the oil price boom.

Average GDP Growth Oil Producers: 2009-2018

Average percent change y/y (%)



Source: IMF, Central Bank of Trinidad and Tobago, Ministry of Finance, Marla Dukharan

Furthermore, a price change that has persisted for 5 years cannot be effectively addressed as shock, but must be treated instead as an adjustment, or even the new normal. We can only strengthen the economy by implementing the policies that support economic diversification, strengthening the non-energy sector, and weaning the economy off deficit spending.

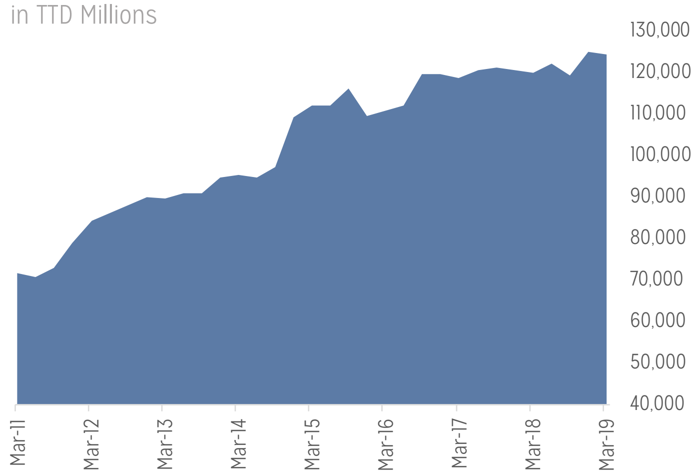
Why do we need fiscal rules?

The conditions under which a government would voluntarily impose limits on its ability to spend are difficult to conceive and probably relatively uncommon. And yet, this is exactly the type of policy that creates long-term sustainable benefits and improved outcomes for all.

The data shows that successive governments have not exercised constraint in fiscal spending on their own. Our debt has grown by 74% since March 2011, reaching TTD124.4 billion in March 2019. That amounts to roughly TTD96,000 in public sector debt per capita. Over the last 10 fiscal years, the central government has spent over TTD520 billion and earned only TTD471 billion.

Gross Public Sector Debt Outstanding: T&T

in TTD Millions



Source: Central Bank of Trinidad and Tobago, Marla Dukharan

The overspending has led to primary fiscal deficits in 5 of the last 6 fiscal years, totalling TTD17.5 billion. This means that the government has had to borrow this sum just to pay the interest on existing debt.

As demonstrated in earlier reports on Errors and Omissions and on availability of foreign exchange in T&T, the data suggest that consecutive governments have not shown the political will to exercise fiscal restraint or to undertake the reforms necessary to put the economy on a sustainable socio-economic development path. Furthermore, empirical evidence has found that fiscal spending in Trinidad and Tobago is even more accommodative in the 12-18 months prior to a general election (Cotton, Finch, and Sookraj, 2013), meaning the situation is likely to get worse over the next fiscal year.

Only when the electorate demands sound fiscal management, and rewards this type of policy stance at the polls over the private gains of fiscal overspending, will policymakers be incentivized to pursue a legislated fiscal responsibility framework regulating the stewardship of public funds.

What could a fiscal responsibility framework look like for T&T?

Ideally, to be deemed fully diversified from a fiscal and export revenue standpoint, we should not incur ongoing non-energy fiscal or balance of payments deficits. This means that the economy would not be reliant on the energy sector to compensate for fiscal or FX shortfalls in the non-energy sector.

Failing this 'utopian' goal, some guidelines include:

1. We should never run a primary fiscal deficit. Recurrent expenditure (excluding interest payments) should not exceed recurrent revenues, and the gross public sector debt level should be maintained accordingly – otherwise we would be borrowing to service interest payments on existing debt.

2. The size of the overall fiscal deficit relative to GDP should be numerically smaller than the real GDP growth rate. In this way, the debt to GDP ratio will not increase. Further, the debt-stabilizing size of the fiscal deficit should not be exceeded.

3. Deposits to the HSF should not take place when there is an overall fiscal deficit, unless the cost of the debt we are raising to finance the deficit is lower than the return being earned by the HSF portfolio, otherwise we are borrowing to save and incurring a negative carry.

4. Tighter control should be exercised over contingent liabilities, as these sometimes end up becoming central government obligations. A profitable, creditworthy state-owned enterprise shouldn't need a government guarantee to raise debt within reasonable levels, and should be divested / privately managed where possible. Lossmaking state-owned entities should only benefit from government guarantees alongside a robust reorganization programme to bring the entity to self-sufficiency.

5. A thorough assessment of the social welfare system is desperately needed as there is rampant waste and duplication. While some collect undeserved benefits, many deserving citizens, such as the mentally ill, elderly and disabled, go without.

Once the system has been rationalized, we could consider imposing a minimum or floor on social welfare spending as a proportion of total fiscal revenue, to make sure that those truly in need are appropriately supported.

Why now is the time to demand fiscal rules?

The tradeoff our policymakers weigh now on the scale of political will, puts an appropriate front-loaded adjustment and reform programme (with benefits potentially kicking in at just the right time in the electoral cycle), against a less potentially politically risky, gradual and tentative adjustment process.

There is no better time than the present therefore, to implement the necessary but painful (in the short term) reforms mentioned earlier to break the vicious cycle. We all have our part to play by supporting the necessary reforms, and shifting our mindset to acknowledge the need for private sector led growth going forward, as we already know that higher fiscal spending does not create sustained growth in T&T.